No. 14,090

In the United States Court of Appeals for the Ninth Circuit

HELGA CARLEN, JOHN T. CARLEN, CATHRYN MCKAY, ARTHUR B. MCKAY, ARTHUR R. AND CATHRYN MCKAY AND JOHN T. AND HELGA CARLEN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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Assistant Attorney General.

ELLIS N. SLACK,
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Special Assistants to the Attorney General.

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CITATIONS

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OPINION BELOW

The opinion of the Tax Court (R. 14-26) is reported at 20 T.C. 573.

JURISDICTION

The consolidated petition for review (R. 64-69) involves deficiencies in individual income taxes for the taxable years 1947 to 1950, inclusive. (R. 15.)[1] Sepa-

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[1] The amounts have been stipulated, as follows (R. 29):

Year	Taxpayer	Amount
1947	Arthur R. McKay	$ 561.52
1947	Cathryn McKay	561.52
1947	John T. Carlen	548.01
1947	Helga Carlen	548.00
1948	Arthur R. and Cathryn McKay	3,928.78
1948	John T. and Helga Carlen	3,904.26
1949	Arthur R. and Cathryn McKay	3,071.61
1949	John T. and Helga Carlen	3,093.50
1950	Arthur R. and Cathryn McKay	1,405.86
1950	John T. and Helga Carlen	1,401.90

rate notices of deficiency, covering the taxable year 1947, were mailed to each of the taxpayers on August 24, 1951.[2] A joint notice of deficiency, covering the taxable years 1948, 1949, and 1950, was mailed to the taxpayers John T. Carlen and Helga Carlen on March 21, 1952 (R. 6-7); on the same date a joint notice of deficiency covering the same period was mailed to the taxpayers Arthur R. McKay and Cathryn McKay. Separate petitions for redetermination were filed with the Tax Court, under the provisions of Section 272 of the Internal Revenue Code, by each of the taxpayers, for the taxable year 1947, on November 19, 1951. A joint petition for redetermination was filed by the taxpayers John T. Carlen and Helga Carlen, for the taxable years 1948, 1949, and 1950, on June 17, 1952 (R. 3-11); on the same date, a joint petition for redetermination was filed by the taxpayers Arthur R. McKay and Cathryn McKay, covering the same period.

The decision of the Tax Court sustaining the Commissioner's determinations of deficiencies was entered June 25, 1953. (R. 2.) The cases are brought to this Court by a consolidated petition for review filed by the taxpayers on September 17, 1953. (R. 64-69.) Jurisdiction is conferred on this Court by Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

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[2] By stipulation reducing the record (R. 74-76), only the pleadings in *John T. Carlen and Helga Carlen* v. *Commissioner,* No. 42,123 have been printed as part of the record; the pleadings in the remaining cases, as well as all of the exhibits in all of the cases (R. 74), may be considered as part of the record before this Court for the purpose of briefs and argument.

QUESTION PRESENTED

Whether the Tax Court correctly held that amounts received by the taxpayers under certain contracts for the cutting of timber constituted ordinary income and were not long-term capital gains within the meaning of Section 117 (k) (1) of the Internal Revenue Code, where the taxpayers had no proprietary interest in the cut timber, no right to sell it or to use it in their own business, and where the amounts were received merely as compensation for services rendered.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(j) [as added by Sec. 151 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" * * * Such term also includes timber with respect to which subsection (k) (1) * * * is applicable.

* * * * *

(k) [as added by Sec. 127 (a) of the Revenue Act of 1943, *supra*] *Gain or Loss Upon the Cutting of Timber.*—

(1) If the taxpayer so elects upon his return for a taxable year, the cutting of timber (for sale

or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. In case such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under this paragraph such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has a contract right to cut and shall be binding upon the taxpayer for the taxable year for which the election is made and for all subsequent years, unless the Commissioner, on showing of undue hardship, permits the taxpayer to revoke his election; such revocation, however, shall preclude any further elections under this paragraph except with the consent of the Commissioner.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

STATEMENT

Most of the facts were stipulated (R. 27-35) and were adopted by the Tax Court as its findings of facts (R. 15). Some oral testimony was taken. (R. 45-63.) The facts may be summarized and explained as follows:

As of May 1, 1945, Arthur R. McKay and John T. Carlen formed an oral general partnership to engage in the logging and cutting of timber in Southwest Washington. During all the years in question, the partnership was engaged in the trade or business of logging timber and was not engaged in the business of cutting timber for sale on its own account or for use in its business. (R. 16.)

On March 15, 1945, Rayonier Incorporated and Neuskah Timber Company entered into a contract by the terms of which Neuskah purchased from Rayonier all of the merchantable cedar and spruce timber and certain hemlock located on tracts described in the contract and owned by Rayonier. Title to the timber and risk of loss by fire or other casualty was to pass to Neuskah on cutting. Rayonier was to designate the hemlock to be cut and all logs were to be branded with a distinctive design approved by Rayonier. Neuskah agreed to sell back to Rayonier and Rayonier agreed to buy all hemlock logs cut under the contract. (R. 16.)

On April 23, 1945, Neuskah entered into the following contract with the McKay and Carlen partnership for cutting part of the spruce and cedar included in the Rayonier-Neuskah contract (R. 16-19):

> This contract, made and entered into by and between the Neuskah Tbr. Co. Inc., a corporation, of Aberdeen, Washington, hereinafter called First Party and Arthur R. McKay and John Carlen, of

Aberdeen, Washington, a co-partnership, hereinafter known as McKay & Carlen, and hereinafter called Second Party, Witnesseth:

That First party owns or controls certain timber in Section Thirty (30) and North Half (N½) of Section Twenty-Nine (20) [*sic*], Township Thirteen (13) North, Range Nine (9) West, W. M., Pacific County, Washington.

Second Party agrees to selective log all the merchantable Sitka Spruce and Western Red Cedar on the above described land in accordance with the usual custom. In the conduct of said operation the Second Party agrees to comply with and conform to all the requirements of law now or hereafter during the term of the contract in effect relating to the operation of cutting, logging and removal of timber, or to fire or the prevention of fire and shall hold First Party harmless from any and all damages resulting from the negligence acts of the Second Party or its agents and employees. Upon completion of logging any definite tract Second Party agrees to leave such land, tract or tracts in such condition that certificate of clearance can be obtained from the State departments pertaining to logging and fire.

All logs when cut shall be branded or stamped with a brand or stamp suitable to the First Party, and absolute title and control of all logs, until sold and paid for, shall rest in the First Party.

All Select, Number One (1) and Number Two (2) Sitka Spruce logs are to be delivered to the mill of E. K. Bishop Lumber Company, Aberdeen, Washington. All other Sitka Spruce and all Western Red Cedar logs are to be delivered to any mill or mills on Willapa Harbor, such mill or mills to be designated by First Party.

Second Party agrees to operate at least Forty Eight (48) hours per week and to do each and everything necessary to log and deliver said logs to the various mills and agrees to construct and maintain all necessary roads, furnish all necessary equipment and supplies, do all falling, bucking, yarding, loading, trucking, booming, rafting, scaling and towing and to pay when due all labor, state and federal taxes of every kind and nature whatsoever, including but not limited to industrial insurance, unemployment compensation, medical aid, and agrees to keep said logs free from any and all claims, liens or liability.

The Parties hereto agree that from the total net cash returns from the sale of all logs shall be deducted stumpage of Seven Dollars Fifty Cents ($7.50) on all Sitka Spruce logs and Four Dollars ($4.00) on all Western Red Cedar logs, plus One Dollar ($1.00) on all logs, per thousand feet board measure, and that after such deductions the balance shall be paid by First Party to Second Party for this service, such payments to be made within ten (10) days after said logs are rafted and scaled, such scaling to be done by any recognized scaling bureau, to be selected by First Party.

Time is of the essence of this contract and Second Party agrees to start operations promptly and continue said logging without interruption, barring such factors as bad weather or strikes which are beyond Second Party's control.

It is expressly understood and agreed that in all its logging operations hereunder the Second Party acts as and is an independent contractor and nothing herein contained shall operate to make the Second Party an agent of the First Party or to be construed as authorizing or empowering the Sec-

ond Party to obligate or bind the First Party in any manner whatsoever. It is expressly understood and agreed the First Party and Second Party are not partners or principal or agent.

Neuskah was a subsidiary of E. K. Bishop Lumber Company. On January 31, 1946, Neuskah assigned its contract with Rayonier to E. K. Bishop Lumber Company and thereafter McKay and Carlen dealt with the assignee with regard to the contract. The assignment was approved by Rayonier. (R. 19.)

On November 1, 1946, August 15, 1948, and October 25, 1948, Rayonier and E. K. Bishop Lumber Company entered into additional contracts similar in material respects to the contract between Neuskah and Rayonier. At the time these additional contracts were entered into E. K. Bishop Lumber Company immediately entered into an agreement with McKay and Carlen for the logging of the areas described in the contracts between Rayonier and Bishop. The agreements with McKay and Carlen were oral and contemplated terms and conditions similar to those stated in the contract of April 23, 1945, between Neuskah and McKay and Carlen. Under the basic contracts between Rayonier and Neuskah and E. K. Bishop, Neuskah and Bishop retained the spruce for themselves, but resold all the hemlock and cedar to Rayonier at the market price. (R. 19-20.)

McKay and Carlen faithfully performed its contracts and payments have been made in accordance therewith, including the service charge of $1 per thousand board feet to Neuskah (later E. K. Bishop Lumber Company). McKay and Carlen logged the timber at their own expense and charged all of the costs, including road build-

ing, to current operating expenses. They received the net cash returns from the sale of the logs, less the stumpage charge agreed upon and a service fee deducted by E. K. Bishop Lumber Company, which conducted all the selling, collected the proceeds, and remitted to McKay and Carlen the net amount. (R. 20.)

McKay and Carlen elected to report their gains on the sale of timber under the various contracts under Section 117 (k). (R. 20.)

The Tax Court found that the McKay and Carlen partnership was not the owner of the timber which was the subject of its contracts with Neuskah and Bishop; that although it had the right to cut the timber in question it had no proprietary interest therein which would permit it to sell the timber. It found that all sales were made by Neuskah or Bishop; that the partnership had no contact with purchasers, except insofar as Bishop invoiced itself for logs which it retained. However, the Tax Court concluded that this was simply for bookkeeping purposes and did not purport to evidence a sale by the partnership to Bishop. Absolute title and control of all logs until sold and paid for remained under the contracts with Neuskah or Bishop and the Tax Court rejected the contention that this was merely for the purpose of security. (R. 24-25.)

The Tax Court found that in essence the partnership was operating under a logging arrangement, under which it was to cut timber on lands of another and was to be compensated for the service rendered in an amount based on the market price of the logs. The partnership, it concluded, had no right to sell the timber on its account; it did not cut the timber for use in its trade or business; and it had no control over the timber except to

cut it and deliver it according to the terms of the contracts with Neuskah and Bishop. (R. 25-26.)

Under the circumstances, the Tax Court sustained the Commissioner's determination that the taxpayers were not entitled to the benefits of Section 117 (k) of the Code. (R. 26.)

SUMMARY OF ARGUMENT

The taxpayers, who received funds by virtue of their execution of a contract to cut certain timber were, nevertheless, as the Tax Court held, not entitled to the capital gains benefits afforded by Section 117 (j) (1) and (k) (1) of the Internal Revenue Code. They were not owners of the timber either before or after cutting, and had no right to sell it or to use it in their own trade or business. There was no compliance, therefore, with the conditions of Section 117 (k) (1). Upon examination of all the facts, including the contracts entered into, the Tax Court found that the taxpayers had in essence merely obligated themselves to render services for which they were entitled to compensation based on a fixed formula, and that the amounts received constituted ordinary income.

ARGUMENT

The Taxpayers Were Not Entitled to the Benefits of Section 117 (k)(1) of the Code Since They Were Not Owners of the Timber Cut, and Had No Right Either to Sell It or to Use It in Their Own Trade or Business

The sole question in this case is whether the taxpayers are entitled to the benefits of the capital gains provisions of Section 117 (k) (1) of the Internal Revenue Code, *supra*. The statute permits a taxpayer to elect upon his return to have the cutting of timber considered as if there were an actual sale or exchange of the timber

cut in a given taxable year. The cutting of the timber must be "for sale or for use in the taxpayer's trade or business" and the taxpayer must be one "who owns, or has a contract right to cut" it. If he has owned the timber or has held the contract right for the requisite period, gain is then recognized "in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber." Under Section 117 (j) (1) of the Code, *supra,* the term "property used in the trade or business" (afforded capital gain treatment under Section 117 (j) (2)) includes timber "with respect to which subsection (k) (1) * * * is applicable."

The Tax Court, upon consideration of the virtually undisputed basic facts (R. 15-20), held that the taxpayers were not entitled to the benefits of Section 117 (k) (1). It construed the statute to apply (1) to a taxpayer who was (1) either an owner of timber cut or (2) who had a contract right to cut timber, provided that it was cut either for sale by him or for use in his business. The taxpayers do not contend that this construction of the statute is erroneous. Upon an analysis of the facts, the Tax Court found that the taxpayers did not own the timber in question and did not cut it for sale by them or for use in their own trade or business. On the contrary, it found that under the agreements in question the taxpayers merely performed services for which they were compensated on the basis of the formula stipulated in the written and oral contracts. Hence, it concluded that since the plain requirements of Section 117 (k) (1) were not met, the taxpayers did not qualify for the capital gains benefits under the

statute, but that the compensation which they received for services rendered constituted ordinary income.

The Tax Court was correct in its construction of the statute and in its application of the facts thereto. As to the meaning of the statute, its provisions are plain and unambiguous. It provides, in part:

> If the taxpayer so elects upon his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who *owns* * * * such timber (providing he has *owned* such timber * * * for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. (Emphasis supplied.)

Under this portion of the statute, it is obvious that ownership is a requisite. In this connection, as the Tax Court has pointed out (R. 22-23), the legislative history of the statute indicates that its main purpose was to grant relief to timber owners who were cutting their own timber rather than selling it outright. S. Rep. No. 627, 78th Cong., 1st Sess., p. 19 (1944 Cum. Bull. 973, 993), contains the following statement:

> Your committee is of the opinion that various timber owners are seriously handicapped under the Federal income and excess profits tax laws. The law discriminates against taxpayers who dispose of timber by cutting it as compared with those who sell timber outright. The income realized from the cutting of timber is now taxed as ordinary income at full income and excess profits tax rates and not at capital gain rates. In short, if the taxpayer cuts his own timber he loses the benefit of

> the capital gain rate which applies when he sells the same timber outright to another. Similarly, owners who sell their timber on a so-called cutting contract under which the owner retains an economic interest in the property are held to have leased their property and are therefore not accorded under present law capital-gains treatment of any increase in value realized over the depletion basis.

Cf. *Boeing* v. *United States,* 98 F. Supp. 581 (C. Cls.). There, the taxpayer entered into contracts with logging companies which were to cut, remove and sell timber and which were to pay over to the taxpayer certain specified amounts. The case involved an interpretation of Section 117 (k) (2) of the Internal Revenue Code, with which we are not here concerned. Nevertheless, in discussing the legislative history of Section 117 (k), the court did state (p. 584):

> The legislative history of 117 (k) indicates that Congress' principal purpose was to afford relief to *timber owners.* * * * (Italics added.)

The Tax Court here concluded that the taxpayers were not the owners of the timber in question. The evidence clearly supports that conclusion. The original ownership of the timber was in Rayonier. On March 15, 1945, that company contracted with Neuskah to sell to it all of the merchantable spruce and timber and certain of the hemlock located in specified tracts. Under the specific terms of the contract, title to the timber and risk of loss by fire or other casualty was to pass to Neuskah on cutting. Neuskah agreed to sell back to Rayonier and Rayonier agreed to buy all hemlock logs cut under the contract; Rayonier was to designate

the hemlock to be cut and all logs were to be branded with a distinctive design approved by it. On April 23, 1945, Neuskah entered into a contract with the McKay and Carlen partnership for cutting part of the spruce and cedar included in the Rayonier-Neuskah contract. By the explicit terms of this contract, the parties agreed that "absolute title and control of all logs, until sold and paid for" shall rest in Neuskah. (R. 17.) When the timber was cut, it was to be delivered by the partnership to mills specifically designated by Neuskah. The partnership bound itself to operate for at least 48 hours per week and to log selectively all timber of the species designated. The contract provided that "for this service", (R. 18), Neuskah was to pay to the partnership an amount equal to the net cash returns from the sale of the logs minus fixed stumpage on the various species and minus a service charge of one dollar per thousand board feet. On January 31, 1946, Neuskah, with Rayonier's approval, assigned this contract to the E. K. Bishop Lumber Company, its parent organization. Thereafter, on November 1, 1946, August 15, 1948, and October 25, 1948, Rayonier and Bishop entered into contracts similar in material respects to the contract between Neuskah and Rayonier, and, on the same dates, Bishop and the partnership entered into oral logging agreements, the terms and conditions of which were similar to those stated in the April 23, 1945, contract between Neuskah and the McKay and Carlen partnership. Under all of the basic contracts between Rayonier, on the one hand, and Neuskah and Bishop, on the other, Neuskah and Bishop retained the spruce for themselves, but resold all the hemlock and cedar to Rayonier at the market price. The McKay and Carlen

partnership performed the services and received payment therefor in accordance with the agreements. Bishop conducted all the sales, collected the proceeds and remitted the net amount to the partnership. (R. 16-20.)

Upon these facts, the Tax Court had ample basis for concluding that the timber was sold by Rayonier to Neuskah and Bishop, that "appropriate language indicating a sale was employed" in the contracts between those parties, and that there was no "language importing a sale in the arrangements between the McKay and Carlen partnership and Neuskah and E. K. Bishop." (R. 24.) Before the Tax Court, as here (Br. 8), the taxpayers, in the words of the Tax Court (R. 24), attempted—

> to explain this discrepancy by pointing out that the original written agreement between the partnership and Neuskah, on which the subsequent oral agreements were based, was drafted by a person unskilled in legal terminology. * * *

The rebuttal of this attempted explanation is that there is no evidence, certainly none of a persuasive or conclusive nature, that the partnership owned the timber or had any proprietary interest therein. True, it had a contract to cut the timber, but, as the Tax Court found (R. 16, 24, 25), during all the years in question, the McKay and Carlen partnership was engaged only in the business of logging, not in the business of cutting timber for sale on its own account or for use in its own business. Further, all sales were made by Neuskah or Bishop and the partnership never had any contact with purchasers, except insofar as Bishop invoiced itself for logs it retained. This was confirmed by the testimony

of Arthur R. McKay, who, it may be noted, did not deny that the partnership had no control in the selection of purchasers. (R. 54.) In short, as the Tax Court concluded (R. 25)—

> the essence of the arrangement was that the partnership was employed to cut timber on lands of another for compensation determined on the basis of market price of the logs and that the partnership did not own or have any proprietary interest in the timber, either before or after cutting. * * *

The Tax Court was not obliged, as the taxpayers in effect urge (Br. 8), to accept the testimony of one of the interested parties concerning the meaning of the partnership's contracts, even if it be assumed, *arguendo,* that Mr. McKay's testimony was uncontradicted. *Blumenthal* v. *Commissioner,* 21 B.T.A. 901; *Quock Ting* v. *United States,* 140 U.S. 147.

The taxpayers' view that the explicit reservation of title by Neuskah and Bishop was for security purposes only (Br. 9-10) represents at the most only a choice of possibly conflicting inferences; the Tax Court stated (R. 25)—"we cannot agree." Nor can we agree with the taxpayers' statement (Br. 8-9) that the basic contract between the partnership and Neuskah should be construed as a contract of purchase because it provided that *stumpage* was to be deducted from the total net cash return from the *sale* of all logs. The term "sale" in this provision is, at the most, equivocal; it is as applicable to sale by Neuskah or Bishop (as the Tax Court found) as it is to sale by the taxpayers. As to the significance of the term "stumpage", the sense of the Tax Court's conclusion is that it was merely a mathematical

factor to be used in determining the amount of compensation to be paid the partnership for services rendered.

The taxpayers contend (Br. 7-8) that the invoicing by Bishop indicates that Bishop was selling for the partnership and had to invoice itself because the logs belonged to McKay and Carlen and other owners. However, the Tax Court found that the invoicing "seems simply to have been for bookkeeping purposes and did not purport to evidence a sale by the partnership to Bishop." (R. 24.) This would certainly appear to be a permissible inference, especially since absolute title and control of all logs until sold and paid for remained, under the contracts, with Neuskah and Bishop.

As we have observed, Section 117 (k)(1) applies to one who owns timber, and the Tax Court concluded upon the facts before it that the taxpayers here did not qualify as owners. The benefits of the statute extend also to a taxpayer who has a "contract right to cut" timber. However, in context, the cutting of the timber must be "for sale or for use in the taxpayer's trade or business." Nothing in the language of the statute or in its legislative history suggests that the mere contract right to cut, absent a right to sell the cut timber or to use it in one's own trade or business, entitles one to the benefits of Section 117 (k)(1). Nor do the taxpayers here contend otherwise. The gist of their argument (Br. 18) is that they come within the statute "either on the basis that * * * [they] purchased the timber and were the owners thereof at all times * * * or had a contract right to cut such timber *and to sell the timber or logs in the regular course of* * * * [*their*] *business* * * *." (Emphasis supplied.) The Tax Court found—from the evidence considered above in connection with its conclu-

sion that the taxpayers did not own or have any proprietary interest in the lumber either before or after cutting—that the taxpayers did not have "any proprietary interest which would permit them to sell it." (R. 24.) Further, the Tax Court found (R. 25-26) that the taxpayers did not cut the timber in question "for use in the taxpayer's trade or business," as required by the statute, but that, on the contrary,

> They were loggers and were cutting timber which belonged to others and was to be used by others. The taxpayers themselves did not use the timber and they had no control over it except to cut and deliver it according to the terms of their cutting contracts with Neuskah and E. K. Bishop.

These findings, as well as the findings that the taxpayers did not own the timber which was the subject of their contracts with Neuskah and Bishop, are based upon substantial evidence, are not clearly erroneous, and should be sustained. Rule 52 (a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869.

The taxpayers rely upon *Springfield Plywood Corp.* v. *Commissioner,* 15 T.C. 697, to support their contention (Br. 11-12) that, despite the provisions for sale of the cut timber to Rayonier, Neuskah and Bishop under the basic contracts between those parties, the sales should nevertheless be regarded as made by the partnership. But, as the Tax Court stated (R. 22), *Springfield Plywood Corp.* is not controlling here. That case involved Section 117 (k) (2) of the Code which provides that in the case of the *disposal* of timber held for more than six months prior to such disposal, by the *owner* thereof under any form or type of contract by virtue

of which the owner retains an economic interest in the timber, gain may be determined on the basis of the difference between the amount received for the timber and its adjusted depletion basis. The narrow question in that case was whether the owner of timber "disposed" of it by contracting for its cutting, the parties having agreed (p. 702) that the owner did retain an economic interest in the timber. Section 117 (k)(1) and (2) cover different situations. Under Section 117 (k)(1), a taxpayer may elect to come within its terms only if he is a timber owner or has held a contract right to cut timber for sale or use in his trade or business. Under Section 117 (k)(2), the retention of an economic interest by an owner of timber who disposes of it under any form or type of contract will entitle him to the benefit of the capital gains provisions. As to the instant case, the Tax Court observed (R. 22): "Both parties agree that section 117 (k)(2) has no application to the situation before us."

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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